

Chapter 2

Defining Terms

BEFORE PROCEEDING FURTHER, we must define our terms so that each meaning remains consistent. Otherwise, our reasoning will be vague and ambiguous. Many eminent authors have stressed the importance of clear and precise definitions. I cannot add to this, except to point out the many examples of these same authors falling into the very trap they warn against.

Certain words—such as *wealth*, *capital*, *rent*, and *wages*—require a much more specific meaning in economic reasoning than they do in everyday speech. Unfortunately, even among economists, there is no agreement on the meaning of these terms. Different writers give different meanings to the same term. Even worse, one author will use the same term in different senses. Nothing shows the importance of precise language like the spectacle of the brightest thinkers basing important conclusions on the same word used in different senses.

I will strive to state clearly what I mean by any term of importance—and to use it only in that sense. Further, I will conform to common usage as much as possible, rather than assign arbitrary meanings or coin new terms. The reader should keep these definitions in mind, for otherwise I cannot be properly understood. My desire is to fix the meaning plainly enough to express my thoughts clearly.

Now, we had been discussing whether wages are, in fact, drawn from capital. So let's start by defining wages and capital. Economists have given a sufficiently definite meaning to wages. However, capital will require a detailed explanation, since it has been used ambiguously by many economists.

In common conversation, wages mean compensation paid to someone hired to render services. The habit of applying it solely to compensation paid for manual labor further narrows its use. We do not speak of the wages of professionals or managers, but of their fees, commissions, or salaries. So, the common meaning of wages is compensation for manual labor.

But in political economy, the word wages has a much wider meaning. Economists speak of three factors of production: land, labor, and capital. Labor includes all human exertion in the production of wealth. Wages are the portion of production that goes to labor. Therefore, the term wages includes all rewards for such exertion.

In the economic sense of the term, none of the distinctions of common speech apply. It does not matter what kind of labor it is. Nor does it matter whether the reward for labor is received from an employer or not. Wages, in the economic sense, simply means the return for the exertion of labor. It is distinguished from the return for the use of capital (interest), and from the return for the use of land (rent).

The wages of hunters are the game they kill; the wages of fishermen, the fish they catch. Farmers get wages from their crops. In addition, if they use their own capital and their own land, part of the crop will be considered interest, part rent. Gold panned by self-employed prospectors is as much their wages as money paid to hired miners.

And, as Adam Smith noted, the high profits of retail store-keepers are in large part wages—that is, compensation for their labor, not just for their capital.

In short, whatever is received as the result or reward of exertion is wages. This is all we need to know for now, but it is important to keep it in mind. In standard economics texts, this term is used more or less clearly—at first. Sadly, this clear definition is frequently ignored later on.

The idea of capital, on the other hand, is so beset with ambiguities that it is difficult to determine a precise use of the term. In general discourse, all sorts of things that have a value, or will yield a return, are vaguely spoken of as capital. Economists themselves use the term in so many senses that it hardly has any fixed meaning.*

I could go on for pages citing contradictory—and self-contradictory—definitions from other authors, but this would only bore the reader. You can find further illustration of the confusion among economists and learned professors in any library, where their works are arranged side by side.

What name we call something is not the issue here. The point is to use it to always mean the same thing—and nothing else. Most people, in fact, understand what capital is well enough—until they begin to define it. Even economists use the term in the same sense—in every case except in their own definitions and the reasoning based on them. They apply their particular definition to set up the premise of their reasoning. But when conclusions are drawn, capital is always used—or at least always understood—in one particular sense.

This commonly understood sense separates capital from

* Curious readers may find examples in the original text, pp. 33-36.

land and labor, the other factors of production. It also separates it from similar things used for gratification. The common meaning of capital is, simply put, wealth devoted to producing more wealth. Adam Smith correctly expresses this common idea when he says: "That part of a man's stock which he expects to afford him revenue is called his capital." The capital of a community is therefore the sum of such individual stocks. Said another way, it is the part of the aggregate stock that is expected to procure more wealth.

Political and social writers are even more striking than economic ones in their failure to use capital as an exact term. Their difficulties arise from two facts. First, there are certain things that—to an individual—are equivalent to possessing capital. However, they are not part of the capital of the community. Second, things of the same kind may—or may not—be capital, depending on what they are used for.

Keeping these points in mind, we can use the term capital in a clear and constant manner, without any ambiguity or confusion. Our definition will enable us to say what things are capital and what are not. The three factors of production are land, labor, and capital. The term capital is used in contradistinction to land and labor. Therefore, nothing properly included as either land or labor can be called capital.

The term land does not simply mean the surface of the earth as distinguished from air and water—it includes all natural materials, forces, and opportunities. It is the whole material universe outside of humans themselves. Only by access to land, from which their very bodies are drawn, can people use or come in contact with nature.

Therefore, nothing freely supplied by nature can be

properly classed as capital.

Consider a fertile field, a rich vein of ore, or a falling stream, which can supply power. These may give the owner advantages that are equivalent to possessing capital. However, calling them capital would end the distinction between land and capital. It would make the terms meaningless in relation to each other.

Similarly, the term labor includes all human exertion. So human powers can never be properly classed as capital. This, of course, applies whether they are natural or acquired powers. In common parlance, we often speak of someone's knowledge, skill, or industry as his or her capital. This language is obviously metaphorical. We cannot use it in reasoning that requires exactness. Such qualities may increase income, just as capital would. The community may increase its production by increases in knowledge, skill, or industry.

The effect may be the same as an increase of capital. However, the increase in production is due to the increased power of labor, not capital. Increased velocity may give the impact of a cannon ball the same effect as increased weight. Nevertheless, weight is one thing and velocity another.

Therefore, capital must exclude everything that may be included as land or labor. This leaves only things that are neither land nor labor. These things have resulted from the union of the two original factors of production. In other words, nothing can be capital that is not wealth.

Many of the ambiguities about capital derive from ambiguities in the use of the inclusive term wealth. In common use, wealth means anything having an exchange value. When used as an economic term, however, it must be limited to a much more definite meaning.

If we take into account the concept of collective or general wealth, we see that many things we commonly call wealth are not so at all. Instead, they represent the *power to obtain wealth* in transactions between individuals (or groups). That is, they have an exchange value. However, their increase or decrease does not affect the sum of wealth in the community. Therefore, they are not truly wealth.

Some examples are stocks, bonds, mortgages, promissory notes, or other certificates for transferring wealth. Neither can slaves be considered wealth. Their economic value merely represents the power of one class to appropriate the earnings of another. Lands or other natural opportunities obtain exchange value only from consent to an exclusive right to use them. This merely represents the power given to landowners to demand a share of the wealth produced by those who use them.

Increase in the amount of bonds, mortgages, or notes cannot increase the wealth of the community, since that community includes those who pay as well as those who receive. Slavery does not increase the wealth of a people, for what the masters gain the enslaved lose. Rising land values do not increase the common wealth, as whatever landowners gain by higher prices, tenants or purchasers lose in paying them.

All this relative wealth is undistinguished from actual wealth in legislation and law, as well as common thought and speech. Yet with the destruction of nothing more than a few drops of ink and a piece of paper, all this "wealth" could be utterly annihilated. By an act of law, debts may be canceled, slaves emancipated, land made common property. Yet the aggregate wealth would not be diminished at all—for what some would lose others

would gain. Wealth was not created when Queen Elizabeth graced her favorite courtiers with profitable monopolies, nor when Boris Godunov declared Russian peasants to be property.

The term wealth, when used in political economy, does not include all things having an exchange value. It includes only those things that increase the aggregate wealth when produced or decrease it when destroyed. If we consider what these things are and what their nature is, we will have no difficulty defining wealth.

We speak of a community increasing its wealth. For instance, we say that England increased its wealth under Queen Victoria, or that California is wealthier than when it belonged to Mexico. By saying this, we do not mean there is more land or natural resources. We do not mean some people owe more debts to others. Nor do we mean there are more people. To express that idea, we speak of an increase in population—not wealth.

What we really mean is there was an increase of certain tangible goods—things that have an actual, not merely a relative, value. We mean buildings, cattle, tools, machinery, agricultural and mineral products, manufactured goods, ships, wagons, furniture, and the like. More of such things is an increase in wealth; less of them is a decrease in wealth. We would say the community with the most of such things, in proportion to its population, is the wealthiest.

What is the common characteristic of these things? They all consist of natural substances that have been adapted by human labor for human use. Wealth, then, may be defined as natural products that have been secured, moved, combined, separated, or in other ways modified by human exertion to fit them for the gratification of human desires.

Their value depends on the amount of labor that, on average, would be required to produce things of like kind. In other words, it is labor impressed upon matter so as to store up the power of human labor to satisfy human desires, as the heat of the sun is stored in coal.

Wealth is not the sole object of labor, for labor is also expended to directly satisfy human desires. Wealth is the result of what we may call productive labor—that is, labor that gives value to material things. Wealth does not include anything nature supplies without human labor. Yet the result of labor is not wealth unless it produces a tangible product that satisfies human desires.

Capital is wealth devoted to a certain purpose. Therefore, nothing can be considered capital that does not fit within the definition of wealth.

But though all capital is wealth, all wealth is not capital. Capital is only a particular part of wealth—that part devoted to aid production. We must draw a line between wealth that is capital and wealth that is not capital. If we keep this in mind, we can eliminate misconceptions that have led even gifted thinkers into a maze of contradiction.

The problem, it seems to me, is that the idea of what capital *is* has been deduced from some preconceived idea of what capital *does*. Logic would dictate first determining what something is, then observing what it does. Instead, the functions of capital have first been assumed. Then a definition is fitted to include everything that does, or may perform, those functions.

Let us adopt the natural order and ascertain what capital is before declaring what it does. The term in general is well understood; we need only make the edges sharp and clear. If actual articles of wealth were shown to a dozen

intelligent people who had never read a line of economics, it is doubtful that they would disagree at all about what was capital or not.

No one would think of counting as capital someone's wig, or the cigar in the mouth of a smoker, or the toy a child plays with. But we would count, without hesitation, a wig for sale in a store, the stock of a tobacconist, or the goods in the toy store. A coat made for sale would be accounted capital; but not the coat a tailor made to wear. Food used in a restaurant would be capital; but not food in a pantry. Part of a crop held for seed or sale, or given as wages, would be capital; the part used by the farmer's family would not.

I think we would agree with Adam Smith that capital is "that part of a man's stock which he expects to yield him a revenue." As examples, he lists:

- ♦ machines and instruments of trade that aid or lessen labor;
- ♦ buildings used in trade, such as shops, farmhouses, etc. (but not dwellings);
- ♦ improvements of land for agricultural purposes;
- ♦ goods for sale, from which producers and dealers expect to derive a profit;
- ♦ raw materials and partially manufactured articles still in the hands of producers or dealers;
- ♦ completed articles still in the hands of producers or dealers.*

If we look for what distinguishes capital in this list, we will not find it among the character or capabilities of the

*Smith's original list included two items that do not fit under George's definition of capital. See original text, p. 47.

items (though vain attempts have been made to do so).

The key, it seems to me, is whether or not the item is in the possession of the consumer. Wealth yet to be exchanged is capital. Wealth in the hands of the consumer is not.

Hence, we can define capital as wealth in the course of exchange. We must understand here that exchange does not mean merely passing from hand to hand—it also includes the increase in wealth from the reproductive or transformative forces of nature. Using this definition, we can include all the things that capital properly includes, and eliminate all it does not.

This definition includes all tools that are really capital. For what makes a tool capital is whether its uses or services are to be exchanged or not. Thus, the lathe used to make things for exchange is capital; one kept as a hobby is not. Wealth used in the construction of a railroad, a theater, or a hotel is wealth in the course of exchange. The exchange does not occur all at once, but little by little, with an indefinite number of people—yet there is an exchange. The consumers are not the owners, but rather the patrons who use these facilities.

This definition is consistent with the idea that capital is that part of wealth devoted to production of more wealth. But to say production is merely “making things” is too narrow an understanding of the term. Production also includes bringing things to the consumer. Storekeepers are as much producers as farmers or manufacturers. The stock in a store is capital, and it is as much devoted to production as the capital of the others.

We are not yet concerned with the functions of capital. That will be easier to determine later. Nor is the definition itself important. I am not writing a textbook;

I am trying to discover the laws governing a great social problem. My purpose here has been to help the reader form a clear idea of what things are meant when we speak of capital.

In ending this chapter, let me note what is often forgotten. Terms like wealth, capital, and wages, as used in political economy, are abstract terms. Nothing can be stated or denied about them unless it applies to the whole class of things they represent. The idea of wealth involves the idea of exchangeability. To possess a given amount of wealth is potentially to possess any or all types of wealth that would be equivalent to it in exchange. Of course, the same is true of capital.

The failure to bear this in mind has allowed fallacies, which otherwise would be transparent lies, to pass for obvious truths.